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MEMORANDUM FOR: Interagency Committee on Overseas Allowances and Benefits

FROM : Working Group on Compensation for Extraordinary Living Costs

SUBJECT : Taxation of Allowances

1. We are forwarding this memorandum because the House Ways and Means Committee is currently deliberating whether or not to repeal Section 912 of the Internal Revenue Code. The two allowances of concern to our Working Group are the Post Allowance and the Separate Maintenance Allowance.

2. The Post Allowance compensates employees for serving at a post where the cost of living is substantially higher than in Washington, D.C. This allowance is designed to enable personnel serving abroad to maintain roughly the same pattern of life they would if they were still assigned to Washington.

3. The Separate Maintenance Allowance (SMA) is intended to help offset the additional expenses of maintaining dependents elsewhere as a result of the employee not being permitted to take his dependents to his post of assignment. The SMA helps to offset out-of-pocket costs incurred in connection with maintaining two households.


4. As is apparent from the foregoing, both the Post Allowance and the Separate Maintenance Allowance simply assist employees to offset costs incurred as a result of an assignment to a foreign post, costs they would not incur if their post of assignment was Washington, D.C. As a result, there is no factor of "additional compensation" contained in either of these two allowances.

5. In our report to the Interagency Committee on Overseas Allowances and Benefits, we made several recommendations concerning the administration of these allowances, and one of these recommendations agreed with the GAO criticism that housing costs should be excluded from the spendable income tables. If this recommendation is adopted, we feel that both allowances will represent only reimbursement for extra costs and, as a result, there would be no compensation value connected with these two allowances which could be considered for taxable income purposes.

6. Should the Ways and Means Committee decide to repeal Section 912, the additional tax liability that would result from that action could be accommodated in the Post Allowance/Cost-of-Living Allowance computation process. In that eventuality the tax liability could be treated as an expenditure item in the same way as other expenditures are treated. If the additional tax liability was included in the Post Allowance process, then the monetary impact on the employees as a result of the repeal of Section 912 could be minimized. While this approach could be accommodated in foreign areas, because of the 25 percent limit on paying a cost-of-living allowance in non-foreign areas, the added tax liability could not be accommodated in every location. This could result in a reduction in income for employees in some non-foreign areas and also result in different treatment between non-foreign and foreign areas -- a situation that should be avoided.

7. In summary, the Group feels that neither the Post Allowance nor the Separate Maintenance Allowance contains a factor of "additional compensation." We strongly endorse the efforts within the Executive Department to prevent the repeal of Section 912 of the Internal Revenue Code.

STATINTL



John F. Blake
Chairman